Moody's Investors Service

Global Credit Research
New Issue
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New Issue: Springfield (City of) MA

MOODY'S UPGRADES TO Baa2 FROM Baa3 SPRINGFIELD'S (MA) UNDERLYING RATING; MIG 1 ASSIGNED TO $2.1 MILLION BANS

Baa2 UNDERLYING RATING WITH A STABLE OUTLOOK APPLIES TO $363 MILLION OF GENERAL OBLIGATION DEBT, ENHANCED Aa3 RATING WITH STABLE OUTLOOK ALSO APPLIES

Municipality
MA

Moody's Rating

ISSUE	RATING
Bond Anticipation Notes	MIG 1

Sale Amount	$2,100,000
Expected Sale Date	06/23/08
Rating Description	Bond Anticipation Notes

Opinion

NEW YORK, Jun 26, 2008 -- Moody's Investors Service has assigned a MIG 1 rating to the city of Springfield's $2.1 million Bond Anticipation Notes (dated June 30, 2008 and payable October 30, 2008). Concurrently, Moody's has upgraded the city's long term rating to Baa2 from Baa3, affecting approximately $363 million in outstanding general obligation debt; the outlook remains stable. The notes are secured by the city's general obligation limited tax pledge as debt service has not been voted exempt from the levy limitations of Proposition 2 ½. Approximately $358 million of the outstanding bonds are authorized under the Commonwealth of Massachusetts (G.O. rated Aa2/stable outlook) Qualified Bond Program (QBP) and carry an enhanced rating of Aa3 with a stable outlook. The notes are issued to provide short-term financing for fiscal 2008 capital projects including road improvements and building maintenance. The MIG 1 rating reflects Moody's expectation that the city will obtain adequate access to capital markets at the notes September 2008 maturity, if renewal is necessary, due to the expectation that the notes will ultimately be permanently financed under the QBP.

The upgrade to Baa2 reflects an improved financial position and positive operating results in fiscal 2006 and 2007 as well as Springfield's significant progress toward establishing sound financial and administrative management practices. Also incorporated in the Baa2 rating are a sizeable tax base with a below-average wealth profile which provides significant regional employment opportunity and governmental services and a moderate debt profile heavily supported by state reimbursements. The stable outlook reflects Moody's recognition of the significant progress achieved by the Springfield Finance Control Board (FCB) and the city's management toward resolution of serious financial problems including significant operating deficits, outstanding collective bargaining contracts, need for the replacement of antiquated and inefficient systems, management of escalating expenditure pressures and development of fiscal policies and long-range planning strategies designed to provide stability and to address the city's significant operating and capital needs. Also factored into the stable outlook is Moody's expectation that the city will maintain prudent long-term budgeting and management practices as transition of financial control from the FCB back to elected officials proceeds ahead of the FCB's expiration on June 30, 2009.

MARKET ACCESS ANTICIPATED DUE TO QUALIFIED BOND PROGRAM ENHANCEMENT

The enhanced Aa3 rating and stable outlook, assigned to all but one of the city's outstanding long-term bond issues, reflect the credit enhancement provided by the Commonwealth of Massachusetts' QBP. The current notes are issued under a debt authorization approved under the QBP. The program is a direct-payment system whereby the commissioner of revenue authorizes the state treasurer to deduct from the city's quarterly state aid payments an amount sufficient to meet the city's debt service on qualified securities. In fiscal 2009 Springfield is projected to receive aid from the commonwealth totaling more than seven times the city's obligation for debt service. The state treasurer makes debt service payments directly to a state-approved paying agent on behalf of the city. Moody's believes that the commonwealth's strong commitment to state aid for municipalities and the program's sound payment mechanisms, which do not rely on the trigger of a notice of potential default, enhance the likelihood of full and timely debt service payment. The programmatic rating is linked to the commonwealth's general obligation rating of Aa2 with a stable outlook.

SPRINGFIELD FINANCE CONTROL BOARD

The FCB was established in July 2004 to secure the financial stability of the city after several years of significant operating deficits, depleted reserves and other accumulated financial liabilities in the city's internal service funds including health insurance. The FCB's authorization is scheduled to expire June 30, 2009; however the members can vote to extend its legal authority at any time. The FCB, which consists of five members: three designated by the commonwealth's secretary of administration of finance, the city's mayor and the president of the city council, has broad financial and administrative powers established under the FCB's enabling legislation. An additional provision of the legislation granted the city access to a $52 million trust fund, with aggregate borrowing to be fully repaid, albeit without an interest charge by fiscal 2012. The city's borrowed the entire $52 million from the trust fund but expended approximately $32 million, the $20 million remainder is held in reserve, under the FCB's control, and is earmarked for economic development. Legislation has been filed to extend repayment of the state loan for 12 years (through fiscal 2019), which would reduce the city's medium term debt service obligations and improve operating flexibility. Today's rating action reflects the progress achieved by the FCB and Moody's belief that guided by newly-developed budgeting and management practices, the transition of financial control to locally-elected officials will be successful.

CONTROL BOARD AND CITY ACHIEVE SIGNIFICANT RESTRUCTURING

Under the direction of the FCB, the city has undertaken a comprehensive review and restructuring of departmental operations, which are projected to yield significant departmental expenditure savings in the medium term. Notable accomplishments include: the January 2007 transfer of administrative responsibility for employee health benefits to the commonwealth's Group Insurance Commission (GIC), which is expected to yield favorable long-term savings; the August 2005 transfer of the Springfield Contributory Retirement System's roughly $280 million in assets to the commonwealth's Pension Reserves Investment Trust (PRIT) in an effort to streamline administrative costs and enhance investment return; and most notably, Springfield's successful settlement of its 28 of its outstanding labor contracts, covering over 5,000 represented employees eliminating a potential $40 million liability for retroactive salary increases related to a wage freeze in 2004. Expirations range from fiscal 2010 to 2013, providing stability in labor costs in the medium term with annual payroll increases projected at 3.1%, assuming the maintenance of current employment levels. The city has also appointed a new police and a new superintendent of schools and although expenditures may increase in the near term due to the city's need to address serious city-wide public safety issues, officials report that each department is undergoing thorough reorganization to modernize operations and improve effectiveness of public safety services.

STABILIZED FINANCIAL POSITION WITH IMPROVING RESERVES

Moody's expects Springfield's financial position to continue to show positive operating results and modest improvement in reserve levels, although significant challenges remain in balancing future budgets without the use of non-recurring revenue sources. Operations in fiscal 2007 produced a modest operating surplus of $3.9 million due largely to conservative revenue budgeting and closely-monitored expenditures. General fund balance totaled $73 million, a satisfactory 13.7% of general fund revenues, and a significant improvement over $7.9 million general fund balance in fiscal 2003, a very slim 1.9% of revenues. Additionally, available reserves (unreserved general fund and stabilization fund balances) grew to $94 million, a sound 17.7% of revenues and a healthy increase over the city's $2.1 million available reserve in fiscal 2002, which represented a minimal 0.5% of revenues. While roughly 57% of the increase in available reserves reflects the proceeds from the $52 million state loan, the city's state-certified free cash, which excludes the $20 million unspent loan proceeds, has improved to $30.4 million in fiscal 2007, a satisfactory 5.7% and a considerable improvement from the negative $57.5 million certified in fiscal 2002. City officials plan to increase free cash incrementally to maintain between 5 and 10% of operating revenues in reserve. Management projects a moderate operating surplus in fiscal 2008 due again to a conservative budgeting approach and prudent expenditure management; an additional transfer to stabilization reserves is anticipated to further bolster the city's ability to respond to unforeseen financial pressures.

The fiscal 2009 budget, which for the first time since establishment of the FCB was created by the mayor and city council, was recently approved by the FCB and includes an expenditure increase of approximately 4%. The budget was balanced without layoffs or significant draws on reserves, although a $2.3 million reserve draw was appropriated from stabilization reserves for pay-as-you-go capital. Despite the long-term certainty provided by the city's collective bargaining contracts, recently settled through fiscal 2012 (although the teachers' contract expires in fiscal 2010, representing nearly half of the city's 5000 municipal employees), the city faces ongoing expenditure pressure from salary-related expenditures as pension contributions increase to improve the current 42.6% funding status and meet the commonwealth's required full-funding deadline of 2028. Although funding of OPEB liabilities is not required in Massachusetts, the city plans to comply with GASB 45 reporting requirements and has identified a preliminary unfunded accrued actuarial liability of up to $450 million; future funding for this liability above the current pay-as-you-go level of $57 million has not been budgeted and could exert additional expenditure pressure in the future. Springfield's multi-year budgeting forecasts indicate significant budget gaps for the foreseeable future and the city's success in resolving its projected operating deficits will be an important factor in maintaining a healthy long-term credit profile. The efficient transition of financial control as the FCB expiration approaches and sustained local aid from the commonwealth, which represented a substantial 63.6% of revenues in fiscal 2007, will also be significant factors. Under Proposition 2 ½, Springfield remains constrained in its ability to raise additional property tax revenues which represented 26.5% of revenues in fiscal 2007. Collections had averaged roughly 97% since 2000 but have improved to over 99% in fiscal 2007, although some of the improvement reflects aggressive collection of prior years' overdue accounts. While the city's financial position has improved, Springfield is likely to face continuing challenges as operating and capital expenditures continue to rise.

ECONOMIC DEVELOPMENT CRITICAL TO LONG-TERM TAX BASE GROWTH

Springfield's $7.1 billion tax base is expected to experience mild contraction in the short term in line with regional and national real estate market trends. Following a 30% decline in the early 1990's the city experienced a sustained period of assessed valuation growth averaging 7.4% annually since 2000. However, growth in 2008 slowed to 5% and is projected to decline at least 5%, reflecting regional weakening in the residential sector, which in Springfield comprises a substantial 82%, of the tax base. The city is the center of economic activity in western Massachusetts, with health care, financial services, government, manufacturing and higher education sectors represented as major employers. Favorably, new growth revenue has averaged $4.1 million since 2004, providing an important source of financial flexibility for the operating budget. Building permit activity is expected to continue solid growth as city-wide redevelopment projects progress. City officials report that new growth is driven by single-family home construction and renovations as well as commercial development and newly-captured personal property levies. Not captured in the city's equalized value are the tax-exempt facilities of Western New England College and Law School (rated Baa2), Springfield College (rated Baa1), Springfield Technical Community College (not rated) and American International College (not rated). Total enrollment is estimated at 24,300 while employment totals 2,000 full-time-equivalent positions. Recent expansion of these institutions has yielded approximately $37 million in new educational facilities, underscoring the importance of the higher education sector as an important source of stability and growth to the local economy.

City officials plan to maximize tax base growth through implementation of a neighborhood development plan designed to target commercial redevelopment and blight reduction as well as roadway, parks and infrastructure upgrades. Funding sources have not yet been identified for every project, however the city expects significant private, federal and state participation in this initiative. Construction is now complete for a federal courthouse designed by architect Moshe Safdie, and other notable projects include roadway improvements to be funded by ongoing commonwealth Chapter 90 funding and a proposed $12 million private redevelopment of the former basketball hall of fame that became an entertainment and fitness facility. The city may offer tax incentives to private developers to encourage additional development but officials are evaluating the tax incentive policy before finalizing future agreements. Springfield is also coordinating public and private agencies to manage residential bank foreclosures, which have increased over 28% since 2007. Income and wealth levels in Springfield are significantly lower than state medians: the April 2008 unemployment level of 5.8% and the 1999 poverty level of 23.1% are significantly higher than commonwealth and national medians of 3.9% and 4.8%, respectively. The city's equalized value per capita of $47,090 is well below commonwealth and national medians of $121,705 and $66,495, respectively.

ABOVE-AVERAGE DEBT BURDEN DUE TO CAPITAL PLAN UPDATE AND STATE LOAN REPAYMENT

Moody's anticipates that the city's elevated direct debt burden (6.2% of equalized value) will increase over the medium term as the city begins to address accumulated deferred maintenance and other capital needs while also assuming the burden of repayment of the commonwealth's $52 million loan. Amortization of principal is a satisfactory 74.3% in 10 years, inclusive of the proposed 12-year repayment of the state loan. The city receives annual reimbursement from the commonwealth for 90% of debt service related to bonds originally issued to finance school construction projects, which represent 63% of the city's outstanding general obligation debt. The city's debt burden falls to a still elevated 4.7% after deducting the expected school construction reimbursement. Gross debt service accounted for a reasonable 6.7% of the city's operating expenditures in fiscal 2007. The city has recently updated its five-year capital improvement plan (CIP). This borrowing represents short-term financing for the fiscal 2008 capital projects, which represent approximately 9.5% of the city's $221 million in high priority capital needs. Financing plans for the remainder of the projects, which include a $125 million school, are incomplete at this time. However city management expects to leverage state and federal funding for up to 60% of the CIP. Furthermore, included in management's comprehensive financial policies are prudent debt limits including maximum future general fund debt service of 5% of annual revenues and a minimum principal amortization schedule of 65% in 10 years. Springfield has no exposure to variable or auction rate debt or swap agreements.

KEY STATISTICS

2006 Population (estimate, US Census): 151,176 (-0.6% since 2000)

2007-8 Equalized Valuation: $7.12 billion

2007-8 Equalized Valuation per Capita: $47,090

Average Annual Growth, Equalized Valuation (2002-2008): 8.9%

Direct Debt Burden: 5.6% of equalized valuation

Overall Net Debt Burden, adjusted for commonwealth school construction aid: 4.7% of equalized valuation

Amortization of Principal (ten years): 74.3%

1999 Per Capita Income: $15,232 (58.7% of commonwealth, 70.6% of nation)

1999 Median Family Income: $36,285 (58.8% of commonwealth, 72.5% of nation)

FY07 General Fund Balance: $73.25 million (13.7% of General Fund revenues)

FY07 Undesignated General Fund Balance: $53.64 million (10.1% of General Fund revenues)

Long-term G.O.L.T. debt outstanding: $340 million ($335 million state-qualified)

Outlook

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The stable outlook reflects Moody's belief that the FCB and city management have effectively eliminated operating losses, and that Springfield's financial position has stabilized. Nonetheless, serious financial and administrative challenges remain and could be compounded by a faltering regional economy. The city is better positioned to restore public confidence in Springfield's ability to self-govern, improve its long-term financial health and reinstate local control after the FCB sunsets in June 2009. Adherence to sound financial and management policy, effective long-term capital planning and sound economic development programs will be critical to enhancing the city's credit strength.

WHAT COULD MOVE THE RATING UP?

*Trend of operating surpluses and augmentation of unrestricted reserves outpacing revenue growth

*Successful transition to local control

*Effective multi-year planning resulting in balanced budgets without use of one-time revenues

*Adherence to Springfield's proposed comprehensive financial policies

*Continued tax base expansion resulting in new growth revenue exceeding current levels

*Favorable resolution of repayment terms for commonwealth trust fund loan

*Ability to achieve progress toward required funding of pension and management of OPEB liabilities

WHAT COULD MOVE THE RATING DOWN?

*Deficit operations

*Increasing reliance on one-time revenue sources in the medium term

*Reduced liquidity requiring a return to cash flow borrowing for operating needs

*Failure to maintain adequate control over operating expenditures

*Imposition of unfavorable trust fund repayment terms

*Reductions in state and federal aid below current levels

*Significant declines in tax base growth

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